

Nevada Housing Division

Section 1602

(Cash in Lieu of Tax Credits)

PROPOSED Project Criteria and Program Procedures

August 13, 2009

Background

Under Section 1602 of the American Recovery and Reinvestment Tax Act of 2009 (Section 1602), State housing credit agencies are eligible to receive Section 1602 Grants to States for Low Income Housing Projects in Lieu of Low Income Housing Credits under Section 42 of the Internal Revenue Code (the Code) for 2009. In doing so, the State Housing Credit Agency is electing to take a portion of its 2009 State housing credit ceiling in the form of grant amounts and agreeing to the terms and conditions applicable to the Section 1602 program.

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (Public Law 111-5), an omnibus bill containing several parts including the American Recovery and Reinvestment Tax Act (ARRTA) of 2009. The purpose of the Recovery Act is to preserve and create jobs and promote economic recovery in the near term and to invest in infrastructure that will provide long term economic benefits.

Section 1602 of the ARRTA appropriates funds for grants to States to finance construction or acquisition and rehabilitation of qualified low income buildings for low income housing in lieu of low income housing tax credits. The US Department of Treasury will award Section 1602 grants to State housing credit agencies in an amount equal to their low income housing grant election amount.

The grant election amount is the amount requested by the State which does not exceed 85 percent of:

- 1) 10 times 100 percent of (a) the unused State housing credit ceiling (if any) of the State for calendar year 2008 and (b) the amount of State housing credit ceiling returned in 2009, plus
- 2) 10 times 40 percent of (c) the greater of \$2.30 multiplied by the State population or \$2,665,000 and (d) unused housing credit carryover allocated to the State in the 2009 National Pool.

The State housing credit agency receiving the grant uses the funds to make subawards to finance the construction or acquisition and rehabilitation of qualified low income building with or without an allocation under Section 42 of the Code. The subawards are subject to the same requirements as low income housing credits under Section 42 of the Code.

It is expected that the Section 1602 program will temporarily fill the gap left by a diminished investor demand for low income housing tax credits.

Under the Section 1602 Program, the Nevada Housing Division (NHD) anticipates exchanging 100 percent of its unused 2008 9% Low Income Housing Tax Credits and up to 40 percent of its 2009 9% Low Income Housing Tax Credits (LIHTC) to the U.S. Department of Treasury and receive a cash equivalent in lieu of tax credits. It is anticipated that these exchanges will produce approximately \$45,000,000.00. The cash equivalent will be distributed by NHD in a priority manner. First priority will be to fund approved 2008 9% LIHTC projects that previously received a reservation of LIHTC at an amount equivalent to the initial equity sought for the project or an amount, at NHD's discretion, that makes the project viable. The second priority will be to use Section 1602 funds for approved 2009 9% LIHTC projects that receive a reservation of LIHTC as needed and the third priority will be to fund other eligible multi-family, low income housing developments.

Any project that receives funding will be subject to NHD's Section 1602 procedures and may, at the discretion of NHD, be subject to funding recapture for non-compliance. NHD's procedures, once finalized, may change from time to time based upon new guidance from the U.S. Department of Treasury. NHD will announce and publicize changes to Section 1602 program guidelines on its website: www.nvhousing.state.nv.us under the Programs, Low Income Housing Tax Credits tab. Program participants are urged to check the website frequently. *It is the program participant's responsibility to ensure their project complies with the NHD Section 1602 program.*

Definitions

Except as otherwise set forth herein, the terms used in the Section 1602 procedures will have the same meaning as under IRS Code Section 42, federal regulations, the NHD 2008 and 2009 Qualified Allocation Plans (QAPs), Treasury's "Grantee Terms and Conditions", and legal agreements between the NHD and Project Owners.

Section 1602 Applicant: An eligible applicant is the developer of a multi-family, low income housing property. The applicant may be a non-profit, for-profit, or partnership.

Eligible Property: Eligible properties are multi-family properties that provide low income housing whereby at least 40% of the units are affordable to households with incomes at or below 60% of area median income or 20% of the units are affordable to households with incomes at or below 50% of area median income *and* the property meets the other requirements of the IRC Section 42 program in terms of rents, eligible basis, and other required elements.

Eligible Costs: Costs allowable in the eligible basis of a project as defined in IRC Section 42.

Owner: For 2008 and 2009 LIHTC projects, the owner, at a minimum, must include the original for-profit or non-profit entity identified in the original application. For all other projects, the owner must be as identified in an original application submitted and funded by NHD for tax exempt bond financing or as identified in an original application made to a local government agency and funded by a local government agency.

The terms Owner, Project Owner, Project Sponsor, and Project Partnership are used interchangeable within these procedures to identify the person(s) responsible for the development of the low income housing project.

NHD will not be part of a partnership structure for Section 1602 projects.

Good faith effort – to demonstrate a good faith effort, owners must provide written documentation acceptable to NHD showing submission of rejection letters, phone logs, failed Letters of Intent (LOI), or other methods acceptable to NHD, that the Section 1602 applicant contacted and/or attempted to negotiate with at least two (2) tax credit syndicators or tax credit investors and could not close on the original tax credit equity. The good faith effort must have been made within the previous 365 days.

Program Criteria

All requests for Section 1602 funds must be supported by a documented good faith effort to attract and secure tax credit equity through a tax credit syndicator or tax credit investor for their project. As defined by NHD, a “good faith effort” includes demonstrating to NHD, through submission of rejection letters, phone logs, failed LOI, or other methods acceptable to NHD staff, that the Section 1602 applicant and project owner contacted and/or attempted to negotiate with at least two (2) tax credit syndicators or tax credit investors and could not close on the tax credit equity. The “good faith effort” must have been made within the previous 365 days.

For 2008 9% LIHTC projects that request Section 1602 funds, the project must currently be in compliance with the terms of its carryover and 270-day (or other NHD noted extensions) requirements. The applicant must be able to demonstrate that:

- 1) the project continues to meet the appropriate year’s QAP criteria for preference points and project requirements submitted under the initial application and have no outstanding non-compliance items.
- 2) The project must have firm commitments for the remaining required construction and permanent financing to ensure project viability; and
- 3) Owners must be able to draw down and expend 100 percent of their allocated Section 1602 funds before December 31, 2010 and place the development in service by the original placed in service date required under their initial LIHTC allocation of credits, and, in no case later than December 31, 2011.

Project owners will have until December 15, 2010 to submit the information necessary to NHD to disburse Section 1602 funds. Owners will be responsible for

securing sources to cover any part of the Section 1602 funds not submitted for and expended by December 15, 2010.

Project owners will be responsible for setting-up a direct deposit account per State of Nevada requirements to receive reimbursement for Section 1602 funds. Section 1602 awardees must contact Karen Rasner, Chief Accountant, at the NHD at 775-687-2046 for instructions on how to set-up their account.

Projects that have already received IRS Form 8609 from NHD are not eligible to receive Section 1602 funds.

Application Process

There is no separate application process for Section 1602 funds. 2008 9% LIHTC projects interested in Section 1602 funds for all, or a part, of project funding, were required to submit the information requested in the updated 270-day notice posted on the Division's website on April 13, 2009 or subsequent notices. The Division will select from 2009 9% LIHTC projects and 2010 pipelined 9% LIHTC projects those projects that will receive Section 1602 funds. Decisions will be based upon the amount of Section 1602 funds available, LIHTC application rating and ranking, project readiness and ability to meet Section 1602 deadlines, and other factors at the discretion of the Division.

There is no additional application fee but additional asset management fees will apply as outlined in this document.

To evaluate requests and determine the appropriate amount of Section 1602 funds for a project, applicants may be asked to re-submit information including, but not limited to:

- Amount of Section 1602 funds requested
- Revised sources and uses
- Anticipated closing date
- Anticipated construction and completion schedule
- Project status report detailing the current status of the project, such as construction/permanent loan commitments, plans and specs, construction contract, permitting, etc.
- Explanation of the Section 1602 Exchange request in terms of filling the gap caused by syndicator/investors as compared to the most recent rental housing tax credit application
- Documentation/description of readiness criteria

Eligible Uses of Funds

Section 1602 funds may be used for capital investment in eligible rental housing tax credit developments. Section 1602 funds may pay for development costs to the same extent as allowed under Section 42 of the Code.

Section 1602 assistance provided to a development is subject to the same limitations (including rent, income, use restrictions and compliance monitoring) as required by NHD with respect to an award of low income housing tax credits (i.e. as required under Section 42 of the IRC and its implementing regulations), and all other requirements of the American Recovery and Reinvestment Act of 2009.

Section 1602 funds can be used, subject to NHD approval, to repay equity or loans that have financed the construction of the building(s) for eligible costs.

Timeliness and Deadlines

Any project in receipt of Section 1602 funds must begin construction within 90 days of award of Section 1602 funds and must place the project in service no later than December 31st of two years from the date of the original LIHTC allocation or December 31, 2011, whichever is earlier. Projects that are not making sufficient progress in comparison to their outlined construction schedule will be subject to recapture of Section 1602 funds and will be responsible for finding an alternate source of funding to complete the project. Recaptured Section 1602 funds will be provided to another project at the discretion of the NHD.

Projects in receipt of Section 1602 funds are required to demonstrate throughout the construction phase, lease-up phase, and project's affordability period:

- a. Conformance with Section 1602 and NHD eligibility requirements
- b. Owner's ability to expend and draw one hundred (100%) of the award before December 31, 2010 and place in service by the appropriate date.
- c. Conformance to the construction schedule
- d. Firm commitment on other project funding sources and closing on all other funding sources within 90 days of receipt of Section 1602 funds. **NO EXCEPTIONS.**

Procedures

A. Underwriting

All projects receiving Section 1602 subawards are subject to NHD due diligence and underwriting. As part of the underwriting evaluation, NHD or its designee's review will include, but is not limited to, a review of:

Owner(s)

The financial standing of the Owner must be fully investigated. Prior year financial statements must be obtained and reviewed.

All contingent liabilities and guarantees of the Owner must be fully described in the financial statements.

The Owner and any other members of the development team must not be the subject of any materially adverse governmental or private inquiry, proceeding, or litigation.

Real Estate

Real Estate Owned Schedule Statements of real estate owned must be collected for the Partnership. This schedule shall include, but not be limited to, a listing of all real estate ownership, percentage of ownership, construction status, debt service coverage, and occupancy rates.

Development Team Members

The Owner must have identified a reliable and qualified development team, with strong multifamily and Code Section 42 experience. The involvement in the Development of any tenant cooperative must be limited to the capacity of nonbinding advisor to the property manager. The Owner must demonstrate that any other partner has a good reputation and the financial capability to perform its obligations under the Loan Agreement.

Contractor

The general contractor must meet all current licensing requirements. If the general contractor is unrelated to the Developer, then the general contractor must secure construction completion in the event of unforeseen problems during construction by one of the following:

- a. A Letter of Credit equal to or greater than 15% of the construction contract amount; or
- b. 100% payment and performance bonds.

The construction contract must be on an AIA approved form and must provide for a guaranteed maximum price. The Owner must be a party to the construction contract.

Property Manager

The property manager must have experience in the subject market and submarket. The property manager must have experience in LIHTC's and Section 42 compliance and be in good standing with NHD. The property manager may be an affiliate of the Owner, if

appropriate; provided that if the property manager is an affiliate of the Owner, the property management agreement must provide that such agreement will terminate if the Owner is removed under the terms of the Loan Agreement. Staffing must be adequate based on the size and social needs of the Development.

Architect

The architect must carry Errors and Omissions insurance and must meet all current licensing requirements. The architecture contract must be on an AIA approved form. The Partnership must be a party to such contract.

The project is subject to additional underwriting criteria contained within the QAP for the year within which the initial project application was submitted.

B. Award Amount and Disbursement

In addition, as part of the underwriting, NHD will issue an award equal to the anticipated equity in the development's most recent initial application, subject to increases approved by NHD necessary to fund additional reserves. All other requirements and parameters of the most recent approved application will remain in force.

NHD or its designee will verify that the award is consistent with the requirements of Section 42(m)(2) of the Code and that costs are eligible.

The award will be no more than 85 percent of the amount of a building's eligible basis as determined at the end of the first year of the credit period (as defined in Section 42(f)(1) of IRC) and, also for this purpose, eligible basis includes any increase for buildings located in high cost areas under Section 42(d)(5)(B). At project completion, the owner must submit a certified CPA cost certification to document the above.

No funding will be disbursed by NHD until a loan agreement is signed by NHD and the owner and a Declaration of Restrictive Covenants is filed against the property.

No more than 30 percent (30%) of the Section 1602 funds will be disbursed until the following milestones are met:

- Closing and initial funding of all of the construction financing for the project;
- Receipt of the commitments for all permanent financing;
- All owner guarantees in place.

No more than 90 percent (90%) of the Section 1602 funds will be disbursed until the following milestones are met:

- Issuance of final Certificate of Occupancy by appropriate agency;
- CPA cost certification acceptable to NHD;
- NHD certification of compliance with property income and rent restrictions;
- Certification of compliance with NHD energy requirements;

- Funding of the permanent loan; and
- Release of liens from all contractors/sub-contractors submitted.

Ten percent (10%) of each draw will be withheld as retention.

C. Developer Fee

1. The Developer Fee must be the same as stated in the initial LIHTC application.
2. 30% of the developer fee must be deferred and will be provided from project cash flow.
3. 70% of the developer fee will be paid as follows:
 - a. 15% at close of Section 1602 funding and close of all other funding sources
 - b. 25% at construction completion
 - c. 30% at stabilization and issuance of Section 1602 compliance notice by NHD

D. Legal Fees

The owner will pay the legal fees associated with closing the NHD award documents. These fees will be paid at closing. Legal fees will be charged at a rate of \$475 per hour and project sponsors must use NHD's approved attorney. A 50 percent (50%) deposit of legal fees is required before NHD will engage legal counsel.

E. Other Fees

The owner will pay the costs of all third party fees.

F. Types of Financing

Section 1602 Exchange funds will be awarded as a forgivable loan for a thirty (30) or fifty (50) year term, depending upon affordability period selected in the project's initial application, with no interest or principal payments. NHD will subordinate the Section 1602 loan in priority to a conventional lender but will not subordinate beyond second position unless special circumstances can be demonstrated. The loan will be forgiven at 1/30th or 1/50th per year, depending upon affordability period.

Section 1602 funds will be disbursed on a reimbursement basis. Project owner will be required to submit back-up documentation of all costs on AIA approved draw forms to NHD or its designee. All change orders must be evaluated and pre-approved by NHD.

Owner must agree to waive the Section 42 Qualified Contract Provisions.

G. Loan Agreement

NHD will execute a legally binding written Loan Agreement with each owner. The written agreement will set forth all of the Section 1602 program and Section 1602 sub-award requirements including the requirements of Section 42 of the Code applicable to the funding, and will make these requirements enforceable through the recordation of a restriction that is binding on all owners and successors, e.g. a Lien and Restrictive Covenant Agreement. The Section 1602 loan agreement must be signed and dated by NHD and the development owner before any Section 1602 funds are disbursed. Federal funds cannot be drawn from the U.S. Treasury in advance of the need to pay an eligible cost. Section 1602 Exchange funds cannot be drawn from the U.S. Treasury and placed in escrow or advanced in lump sums to development owners.

The written agreement shall impose conditions or restrictions, including a requirement providing for recapture, so as to assure that the qualified low-income building remains a qualified low-income building during the compliance period. No Section 1602 funds may be disbursed to owners after December 31, 2010.

Recapture of Section 1602 funds for non-compliance during the project's affordability period will be according to the formula provided by the US Department of Treasury during the initial 15-year affordability period. Recapture of Section 1602 funds for non-compliance during the remaining 15 to 35-year affordability period will be subject to $1/30^{\text{th}}$ or $1/50^{\text{th}}$, depending upon the project's affordability period, multiplied by the number of years remaining in the affordability period.

Recapture during construction will be subject to the full amount of Section 1602 funds invested in the project and will be triggered by non-compliance to project requirements or lagging more than 90 days behind the anticipated construction schedule (subject to NHD discretion.) Any recapture penalties imposed by the US Department of Treasury will be passed on by NHD to the owner and owner will be responsible for payment.

H. Asset Management

NHD will utilize its contracted Asset Manager for developments that receive funds under the Section 1602 program. All projects that receive Section 1602 funds will be required to contract directly with, or through NHD, with NHD's asset management firm and pay the associated asset management fees outlined in these procedures or fees as updated from time to time. Failure to do so will result in termination of the Section 1602 funds.

NHD will assign the Asset Manager (AM) and it reserves the right to assign or change an AM in its sole discretion to any development receiving an award under the Section 1602 program. The AM will, on behalf of NHD, underwrite projects, perform construction monitoring, including representing NHD at draw meetings, review draw requests and requests for change orders, and ensure compliance with the project application and NHD loan terms, and other tasks as assigned by NHD.

The Asset Manager (AM) shall be responsible to NHD to identify and measure any Development that is deemed "risky". Using the AM's approved risk rating criteria for

development and for operations, the AM will prepare and deliver to NHD a quarterly list of “risky” properties. Developments will also be placed on the “risk” list if they fail to meet any of the required NHD program procedures, milestones, or timeframes.

Project owners will be responsible for paying asset management fees during project construction through initial lease-up and certification and, then, for yearly asset management.

Fees for asset management during project construction and through initial lease up will be \$55,000 per project based on 12 month construction schedule. Additional months of construction management will be billed on a prorated basis based on the negotiated annual construction management rate between the NHD and AM. Yearly asset management fees will be \$7,000 annually and includes property/unit inspections and file reviews. Fees for workouts, if necessary, will be assessed on a case by case basis. Asset management fees are subject to a three percent (3%) annual adjustment factor. NHD will determine which, if any, fees should be paid directly to the AM firm and the project owner may have to enter into an agreement with the AM firm.

Projects receiving both Section 1602 and Tax Credit Assistance Program funding will not be double billed for AM services and will adhere to the AM fees cited herein plus an additional \$15,000 for Davis-Bacon AM services separately contracted.

Projects will also pay a one-time \$5,000 asset management fee directly to NHD for in-house asset management of the project.

The NHD and AM will not have any ownership in the project Partnership.

I. Reporting and Compliance

Property owners will be required to submit monthly progress reports to NHD or its designee detailing construction progress, draws on NHD and other funding sources, and other information as requested by NHD or its designee. Owners will also be required to submit quarterly progress reports with the information required by the US Department of Treasury under the Section 1602 program. This information will be due to NHD or its designee no later than the 5th day after the end of the quarter.

Repeated failure to submit the required monthly or quarterly reports on time could result in recapture of Section 1602 funds. Owners will receive a courtesy notice the first time a monthly or quarterly report is late. Second and subsequent lateness will incur a penalty of \$250 per report.

J. NHD Rights

NHD reserves the right to cause the Owner to remove the property manager and appoint a new property manager in circumstances where the NHD or its designee determines that the same is necessary to protect the interests of NHD or the property.

NHD reserves the right, either itself or through its appointed designee, to conduct annual property monitoring to ensure compliance with project and program requirements. Property monitoring will be the same as NHD conducts under IRC Section 42. Properties that fail to correct non-compliance upon submission of corrections will be subject to a second property compliance fee of \$35 per unit. Properties that have ongoing non-compliance will be subject to recapture of Section 1602 funds.

NHD will follow the same notification procedures as under the LIHTC Section 42 for announcing property compliance visits. NHD reserves the right to conduct unannounced property visits if it receives tenant complaints or if there may be fraud occurring at a property.

NHD reserves the right to approve the withdrawal of an Owner from a Partnership.

K. Qualified Allocation Plan

The project is subject to all other provisions and requirements of the QAP under which the initial application was submitted and approved including, but not limited to, energy requirements, fees, debt to income ratios, preference points, vacancy rate limits, etc.

L. Guaranties

A creditworthy obligor acceptable to the NHD will provide the following guarantees to be included in the Loan Agreements:

1. Project Completion

- a. A guaranty of completion of the construction or rehabilitation of the Development in accordance with the approved plans and specifications and in a good and workmanlike manner, free and clear of all mechanics', material men's, or similar liens and the satisfaction of all financial and non financial obligations of the Partnership through Stabilization.
- b. Guaranty must be unlimited
- c. Amounts paid by the obligor in satisfaction of the Project Completion guaranty are not reimbursable.

2. Operating Deficits

- a. A guaranty of payment of operating deficits during the Compliance Period commencing upon the expiration of the Project Completion Guaranty.
- b. Obligation must be sufficient to cover twelve months of the sum of projected operating expenses, replacement reserve funding, and must-pay debt service payments.
- c. Advances to cover operating deficits must bear no interest and must be repayable solely from cash flow or sale or refinancing proceeds.

M. Property Disposition

NHD reserves the right to approve any proposed sale, exchange, lease (other than leases of dwelling units to individual tenants in the ordinary course of business), mortgage, pledge refinancing, or other disposition of the Development (or any portion thereof) or any material asset of the Partnership.

Upon disposition of the property after the required affordability period (initial and NHD extended affordability periods), NHD or its designee will be entitled to 20 percent (20%) of project proceeds after repayment of any debts due from the partnership (excluding debt due to the partners or project owner) and payment to the Limited Partner as outlined in a partnership agreement if applicable.

Disposition during the required affordability period may trigger recapture of Section 1602 funds.

NHD will not receive any of the annual cash flow from the property.

N. Recapture

NHD shall include in all subawards of Section 1602 funds a requirement providing for recapture to assure that the building remains a qualified low income building during the compliance period. Awardees are notified herewith that any amount subject to recapture becomes debt owed to the United States payable to the General Fund of the Treasury and enforceable by all available means against any assets of the recipient entity.

In the initial 15-year compliance period, A Section 1602 recapture event occurs any time the applicable fraction of a building under Section 42 (c)(1)(B) falls below the percentage of Section 1602 funds that comprise the eligible basis of the building (the Section 1602 percentage), or below the minimum set-aside elected for the building under Section 42(g)(1), whichever is greater. However, the preceding sentence does not apply if the applicable fraction specified in the extended use agreement with respect to the building under Section 42(h)(6)(B)(i) is lower than the Section 1602 percentage. Instead, a Section 1602 recapture event takes place any time within the 15-year compliance period the applicable fraction of the building under Section 42(c)(1)(B) falls below the applicable fraction specified for the building in the extended use agreement under Section 42(h)(6)(B)(i), or below the minimum set-aside elected for the building under Section 42(g)(1), whichever is greater.

For purpose of calculating the Section 1602 percentage, eligible basis includes any increase for buildings located in high cost areas under Section 42(d)(5)(B) of the Internal Revenue Code.

Any recapture penalties due to the Treasury are the responsibility of the project owner.

Recapture may be triggered during the extended compliance period any time the applicable fraction falls below the minimum set-aside, unless prior written approval is received from NHD, or for documented repeated non-compliance with other program or property requirements.

O. Public Input

The proposed Section 1602 Project Criteria and Program Procedures are available for public review from August 13, 2009 to August 28, 2009. Public interested in commenting on the proposed criteria and procedures must submit written comments to:

Hilary Lopez, Ph.D.
Chief of Federal Programs
Nevada Housing Division
1535 Old Hot Springs Road, #50
Carson City, Nevada 89706

Or via email at: hlopez@nvhousing.state.nv.us

Comments must be received no later than 5 p.m. on August 28, 2009.

The NHD will also hold a public information session to discuss the proposed criteria and procedures. The meeting will be separately noticed on the Division's website at www.nvhousing.state.nv.us. Interested parties can also contact the Division at 775-687-2040 for meeting information.

P. Amendments to Section 1602 Project Criteria and Proposed Procedures

The NHD will post updated versions of the Section 1602 Project Criteria and Proposed Procedures from time to time on its website at www.nvhousing.state.nv.us. Changes may be precipitated by updated guidance from the U.S. Department of Treasury, NHD requirements, legal advice to NHD from counsel, or other factors.

Changes may also be made during the initial public review period and interested parties are encouraged to check the website often.

Updated drafts or updates to finalized criteria and procedures will not be redlined but will be watermark date stamped for ease in identifying the latest version.

Q. RESERVED FOR FUTURE USE